IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

LEON W. SCALES and KATHLEEN A. SCALES,
Plaintiffs

v.

ROBERT A. RIDDELL,
Defendant-Appellant

ALLEN J. SUTHERLAND and ESTELLA W. SUTHERLAND,
Plaintiffs

v.

ROBERT A. RIDDELL,
Defendant-Appellant

A. PAUL SUTHERLAND and MARLEINE G. SUTHERLAND,
Plaintiffs

v.

ROBERT A. RIDDELL,
Defendant-Appellant

MONA J. MASON (FORMERLY MONA J. PARKER),
Plaintiff

v.

ROBERT A. RIDDELL,
Defendant-Appellant

JOSEPH LEVIKOW, JR. and ELIZABETH M. LEVIKOW,
Plaintiffs

v.

ROBERT A. RIDDELL,
Defendant-Appellant

FRED J. HOWARTH and PAULINE J. HOWARTH,
Plaintiffs

v.

ROBERT A. RIDDELL,
Defendant-Appellant

ON APPEALS FROM THE JUDGMENTS OF THE UNITED STATES DISTRICT COURT FOR THE CENTRAL DISTRICT OF CALIFORNIA

BRIEF FOR THE APPELLANT

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ON APPEALS FROM THE JUDGMENTS OF THE UNITED STATES DISTRICT
COURT FOR THE CENTRAL DISTRICT OF CALIFORNIA

BRIEF FOR THE APPELLANT

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FOR THE NINTH CIRCUIT

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ON APPEALS FROM THE JUDGMENTS OF THE UNITED STATES DISTRICT
COURT FOR THE CENTRAL DISTRICT OF CALIFORNIA

BRIEF FOR THE APPELLANT

STATEMENT OF THE ISSUES PRESENTED

1. Whether the gain derived by the taxpayers from payment
d discharge of the two promissory notes held in trust for their
nefit was taxable as ordinary income as the Government contended.

2. Whether the gain derived by the taxpayers from their
ofit interest in the Kearney Park land, a part of which was sold
the Navy and a part distributed to the taxpayers, was taxable
ordinary income.

STATEMENT OF THE CASE

The appeals in these six consolidated cases involve refund f income taxes for the calendar year 1958 in the respective amounts f $5,041.59, $41,116.34, $20,313.17, $4,120.25, $3,067.89 and 75,001.85. (Nos. 22,013-22,018, R. 4.)

The taxes, with interest thereon, were paid, on March 23, 1964, nd claims for refund of the taxes, with interest, were filed on pril 6, 1964. (R. 9.) After more than six months had elapsed from he time the claims were filed or on February 17, 1965, suits were ommenced in the lower court. (R. 8.)

The notices of appeal by the Government were filed on April 15, 966, written sixty days after the entry on February 17, 1966 of ummary judgments by the court below in favor of the taxpayers. R. 169, 183-184.) Jurisdiction is conferred on this Court by 28 U.S. , Section 1291.

The facts as found by the District Court necessary for resolution these six consolidated cases may be briefly stated as follows lo. 22,013, R. 94-120):

The Kearney Park Development Corporation (Kearney Park) and Union tle and Trust Company of San Diego (Union), as trustees under its ust R-13357, entered into an agreement, under the date of April 9, 53, for the sale of certain vacant real property (Kearney Mesa operty), in the Kearney Mesa area of San Diego, California. rsuant to that agreement, Union conveyed to Kearney Park the real operty covered by the sales agreement, and in consideration received promissory notes (Kearney Park notes) dated June 4, 1953, in the

respective amounts of $80,000 and $553,750. Each note was secured by a portion of the Kearney Mesa property conveyed. The deed of trust securing the $80,000 note covered approximately 220 acres, and the deed of trust securing the $553,750 note covered an area of 360 acres. (R. 94.)[1/]

The Kearney Mesa property was subject to a prior lien of certain improvement bonds (sewer and water improvements) issued by the Kearney Mesa Improvement District in the approximate amount of $224,000. (R. 94-95.) The improvement bonds (each of which covered a specific parcel of land described by metes and bounds) were 10-year bonds, payable in equal annual installments of principal and semi-annual installments of interest beginning January 2, 1955. (R. 95.)

The Kearney Park notes, dated June 4, 1953, generally provided for periodic payments of principal and interest. The $80,000 note provided for the payment of the principal sum on or before three years from the date, with interest at the rate of five percent per annum on any unpaid balance from and after two years from date of issue. The $553,750 note provided for payment of three annual installments of $54,750, payment commencing two years after the date of the note, with interest at the rate of five percent per annum, and the balance of the principal payable, with interest, on or before five years from the date of the note. Both notes provided that upon a default in the payment of interest, the principal and interest would be immediately due and payable at the option of the holder of the notes. (R. 95-96.)

[1/] "R." references are to the record on appeal in No. 22,013 unless otherwise designated. The facts as stated in No. 22,013 are those involved in the other five consolidated cases on appeal.

In 1955, the principal and interest payments on the Kearney Park tes were in default, and improvement bonds and property taxes were linquent. The notes were then held by Harry Redfield as trustee an Iowa estate. At that time, B. B. Margolis was advised that the o notes could be purchased at a substantial discount. In 1955 and 56, Margolis acquired from Redfield four successive options to quire the two notes. (R. 96.)

In 1955, the public was told of the plans of the Department of e Navy to acquire the Kearney Mesa land which was within the ight pattern of the Miramar Naval Air Station. (R. 96.)

In January of 1956, Margolis and three associates acquired nership of the $80,000 Kearney Park note, and the deed of trust curing it, for a total consideration of $30,000. The undivided terests in that note were as follows (R. 97):

B. B. Margolis	33 1/3%
Joseph Levikow	33 1/3%
Pauline M. Howarth	25%
L. N. Margolis	8 1/3%
	100%

arney Park had made no principal or interest payments on the note that time. (R. 97.)

Margolis and his associates, under the date of February 2, 1956, eated Trust 473, and appointed the Security Trust and Savings Bank San Diego (Security Trust Bank) as trustee. They assigned the),000 note and deed of trust securing it to Trust 473.

Because Margolis and his associates were unable to raise fficient funds to acquire the $553,750 Kearney Park note, they d to seek financial assistance from other quarters. Taxpayer len Sutherland, the president of Security Trust and Savings Bank, s solicited by Margolis for this purpose. A group of associates, cluding Margolis, Sutherland and the other taxpayers herein, was rmed to acquire the latter note. (R. 97.) The undivided interests the parties who acquired the $553,750 Kearney Park note were as llows (R. 98):

	Occupation	Interest
B. B. Margolis	Real estate and insurance	24/120ths
A. J. Sutherland	Banker	12/120
A. Paul Sutherland	Parking lots	12/120
C. D. Dail	Politician	2/120
Joseph Levikow	Broker	12/120
J. M. Wilson	Employee of B. B. Margolis	2/120
Thos. E. Sharp	Retired	20/120
Leon W. Scales	Attorney	4/120
F. S. Parker	Retired	6/120
Pauline M. Howarth	Housewife	20/120
Fred O. West	Unemployed	1/120
L. W. Kimsey	Trust Officer	1/120

arney Park had made no principal or interest payments at the time e associates acquired the $553,750 note. (R. 98.)

The associates owning the $553,750 Kearney Park note created ıst 482, with Security Trust Bank as trustee, and assigned the note l deed of trust securing it to the bank. (R. 98.)

By 1956, two affiliates of Kearney Park, Myers-Kearney, Inc., d Merit-San Diego, Inc., had acquired from Kearney Park certain rcels of real estate securing the two notes. (R. 98-99.)

Security Trust Bank, as trustee of Trusts 473 and 482, and arney Park affiliates entered into an agreement, dated June 15, 56, relating to the two Kearney Park notes and the property curing the notes. The agreement recited, inter alia, that install- nts of principal and interest due on the notes, installments of al property taxes, and installments on the municipal improvement nds were all in arrears. It further recited that the trustee of usts 473 and 482 would postpone payments on the two notes and vance certain payments on the improvement bonds in consideration the trustee being permitted to share in any gain on the disposition the Kearney Mesa property securing the two notes. (R. 99-100.) ecifically, that agreement provided in part as follows (R. 101):

> (d) If the land shall be purchased or condemned by the United States, or other governmental authority, and if the compensation therefor shall be made available for payment on or before December 4, 1957, then all of such compensation shall belong to and shall be disbursed as follows:
>
> (1) To pay off the Improvement Bonds and unpaid property taxes, if required by the terms of the taking, plus payment of the expenses of sale.
>
> (2) To pay in full the principal and interest on the two Kearney Park notes.
>
> (3) To reimburse Trustee for moneys advanced to make payments on Improvement Bonds property taxes, and assessments affecting the land.

(4) To pay $150,000 to Owners, representing the agreed amount of their investment in the land.

(5) To disburse the balance 50/50 to the Trustee and to the Owners.

(e) The Trustee and Owners shall cooperate in connection with all negotiations or litigation with the United States or other governmental authority seeking to acquire the land; and each party shall be permitted to participate in such negotiations or litigation through agents and counsel of their own choosing.

(f) If, on or before December 4, 1957, the United States or other governmental authority seeking to acquire the land shall file a Declaration of Taking, or shall commence court proceedings, the terms of the Agreement shall be automatically extended until there has been a final determination of compensation due for the taking.

At the time the above agreement was entered into, the only prospect for disposition of the land was to the Navy. (R. 102.)

On December 4, 1957, the trustee of Trusts 473 and 482 entered into an agreement with Kearney Park and its affiliates entitled "Amendment to Agreement" which amended the agreement of June 15, 1956. This agreement recited that no payment of principal or interest had been made on the two notes and that no disposition of the property covered by the agreement of June 15, 1956, had been made. (R. 102.) This agreement then went on to provide in part as follows (R. 103-104):

(d) The parties agree that if all or any part of the real property owned by Owners shall be sold to "any one or more persons," including the United States or any agency thereof, and including any State or municipal corporation, on or before December 4, 1958; or in the event all or a portion of the property is condemned by anyone possessing the power of eminent domain, then all sums realized from the sale or condemnation (if sufficient to discharge the first four items listed below) "shall belong to and shall be disbursed and distributed" as follows:

(1) To pay the Improvement Bonds and property taxes, if required to be paid by the terms of the sale or taking, plus the costs of sale.

(2) To pay principal and interest on the two Kearney Park notes.

(3) To pay trustee for advances made to pay principal, interest, and penalties relative to Improvement Bonds and property taxes or assessments.

(4) To pay Owners the total of sums paid by them subsequent to June 15, 1956, in payment of principal, interest, and penalties relative to Improvement Bonds, property taxes, and assessments.

(5) To pay Owners $150,000, representing the agreed amount of their investment in the land.

(6) To pay in full any delinquent taxes on, and Improvement Bond principal and interest of Bonds secured by, any of the subject land not sold or taken, unless the parties otherwise agree.

(7) The remainder "shall belong to and shall be distributed to the parties in equal shares."

(e) If any land remains unsold or not condemned (after the payment of the first five items listed in (d), supra), "then Owners will convey to Trustee and (sic.) undivided one-half interest in and to all such land," the conveyance to be made at the time of the distribution of the moneys mentioned in item (7) of (d), supra (paragraph 6).

The acquisition of the land near the Miramar Naval Air Station
s negotiated and finalized by the Navy. Funds for the acquisition
re made available to the Navy for this purpose on February 10,
58. This included acquisition of the land securing the two notes
trust. Because the funds finally made available to the Navy for
e land acquisition were reduced in amount, the amount of land
tually acquired by the Navy from Kearney Park and its affiliates
s, in turn, reduced. (R. 104-105.)

The actual negotiations between the Navy, and the selling group Kearney Park interests, and Trusts 473 and 482) took place on ebruary 14, 1958. At this conference, the Navy made an offer to urchase a part of the subject land for $1,434,000. The selling roup finally offered to sell the total subject land for $1,500,000, hich was accepted by the Navy. (R. 104-105.)

Kearney Park and its affiliates transferred title to 458 acres Kearney Mesa land to the Navy for the aggregate consideration of ,500,000. This acreage acquired by the Navy from the group cluded all the property securing the $553,750 note held in Trust 2, and approximately 106 acres of the 220 acres securing the 0,000 note held in Trust 473. (R. 105.)

Pursuant to the agreement of December 4, 1957, Kearney Park and s affiliates conveyed to the trustee of Trust 473 an undivided e-half interest in the real property not purchased by the Navy pproximately 114 acres), which had been covered by the deed of ust securing the $80,000 Kearney Park note. (R. 105.)

On March 14 or 15, 1958, B. B. Margolis entered into an reement with taxpayer Allen Sutherland to assign to Sutherland his neficial interests in Trusts 473 and 482 for $200,000. The terms e cash payment of $80,000 and Sutherland's promissory note for 0,000 due in 90 days. Margolis received Sutherland's check for ,000, dated April 3, 1958. The $120,000 balance owing to Margolis Sutherland was to be paid from funds due Sutherland out of the ceeds of either or both Trusts 473 and 482. (R. 106.)

On April 11, 1958, the trustee of Trusts 473 and 482 received he $1,500,000 purchase price from the Navy for the land acquired y it. Of the total sum, $261,500 was received by Trust 473 and 1,238,500 was received by Trust 482. These sums were distributed n accordance with the provisions of the agreement of December 4, 957. (R. 106.)

On April 15, 1958, the trustee issued checks for taxpayer llen Sutherland's shares of the monies received from the Navy as ollows (R. 107):

(a) Trust 473 (33 1/3% interest) $49,863.92

(b) Trust 482 (36/120ths interest):

(1) $120,000 to B. B. Margolis as instructed
(2) $124,418.21 to Sutherland

he $120,000 check issued to Margolis was actually delivered to him on pril 22, 1958. (R. 107.)

Taxpayers Scales, Mason, Levikow and Howarth computed their ain from the transaction after distribution by the Trusts, and in heir income tax returns for the year 1958, reported the gain as apital gain. (R. 107, 114, 116, 119.) Taxpayers Allen Sutherland nd Paul Sutherland elected to treat part of their proceeds as on-recognizable gain from involuntary conversion, and a part as rdinary income (interest and discount income). (R. 110-114.)

The Commissioner, in his notices of deficiency to each taxpayer, omputed the fair market value of the land (approximately 114 acres) ot sold to the Navy and transferred to Trust 473 and determined

hat the recomputed gain on the sale and distribution by the trusts as taxable, in full, as ordinary income. (R. 108, 110-111, 113, 14-115, 116-117, 119.)[2/] As noted above, the deficiencies were paid, laims for refunds were filed, and after more than six months had lapsed from the time the claims were filed, suits for refunds were mmenced in the court below. (Nos. 22,013-22,017, R. 2-4; No. 22,018, 2-5.)

Thereafter, the taxpayers filed a motion for summary judgment, with fidavit on October 25, 1965. (R. 78-82.) The United States on tober 25, 1965, filed a cross-motion, with affidavit, for partial mmary judgment. (R. 124-127.)

On February 17, 1966, the lower court entered an order denying e Government's motion for summary judgment (R. 167), and granted mmary judgments for the taxpayers (R. 169) which provided that he defendant refund to" the taxpayers certain "taxes * * * with terest from the date of payment" on certain "transactions * * * the extent that such taxes were assessed on the net proceeds as dinary income and not as capital gain." Thereafter, or on April 15, 66, the Government filed notices of appeals from the judgments. . 183.)

[2/] The Commissioner determined additional deficiencies with respect taxpayer Howarth involving certain payments of alimony. (R. 118-9.) Since that issue is not in contest in this Court, further ntion of it would appear unnecessary.

Because the summary judgment failed to decide the issue of the fair market value of the 114 acres of Kearney Mesa land not sold to the Navy, the lower court, on May 31, 1966, rendered a second judgment which recited that the earlier order was only a partial summary judgment, leaving for further litigation the factual issue of the fair market value of such 114 acres. (R. 191.) Rather than trying the issue of the fair market value of the remaining 114 acres, the parties stipulated that the value of that acreage was $250,000. Accordingly, subsequent thereto, or on March 16, 1967, a so-called stipulated judgment was entered which recited the agreement of the parties that the fair market value of the 114 acres was $250,000, that no further issues remained to be litigated, and that "therefore, this stipulated judgment coupled with the judgment entered on February 1966, constitutes a final judgment in this matter." (R. 178.)

Thereafter, the taxpayers filed motions seeking to dismiss the government's notices of appeal. This Court denied those motions. Then, the taxpayers filed a petition for writ of certiorari seeking review of this Court's denial of the taxpayers' motions to dismiss the appeal. The Supreme Court denied the petition.

SUMMARY OF ARGUMENT

The taxpayers, along with others, acquired two promissory notes cured by certain realty at substantial discounts. Taxpayers trans- rred the notes to two trusts and acquired interests therein uivalent to the interests they held in the notes. In consideration r their forbearance of the collection of the notes, and advancement certain sums, the trusts acquired the right to receive 50 percent the profits from the sale of the realty securing the two notes.

It was generally understood at the time that the Department of e Navy expected to purchase the entire tract for Navy purposes.

Thereafter, the Department of the Navy did purchase all the land curing the two notes except 114 acres which it was prevented from ing because of a cut back in the funds made available to it. Thus, llowing the sale to the Navy and the resulting consummation of their int venture, the taxpayers, through the trusts, received payment of the paid principal and interest on the two notes, and additionally eived 50 percent of the profits from sale of the land, including kind one-half of the remaining 114 acres. The lower court roneously held that the entire gain on the transactions was taxable the taxpayers as capital gain. The Government submits the entire n is taxable as ordinary income.

The gain from the payment to the taxpayers of the principal and erest of the two promissory notes is clearly ordinary income to m. Where an indebtedness is paid off and discharged, it is well

ablished that such a transaction does not amount to a sale or
hange and thus cannot qualify for the favored capital gains
atment.

The gain realized by taxpayers from a disposal of their 50
cent profit interest in the real estate is also taxable as ordinary
ome. Property which is held for sale to customers in the ordinary
rse of ones business is not a capital asset and does not qualify
capital gain treatment. The taxpayers along with B. B. Margolis,
uired their interests in both the notes and the underlying real
ate as parties to a joint venture. They held the interest in the
lty for no other reason than for sale to customers in the ordinary
rse of the business of the joint venture. This Court has already
ed that B. B. Margolis, one of the joint venturers, held his
erest in the real property for sale to customers in the ordinary
rse of business. That prior holding of this Court unquestionably
racterizes the nature of the instant taxpayers' interest in the
l property and should be binding on them in this action.

ARGUMENT

THE SUMMARY JUDGMENT OF THE DISTRICT COURT THAT ALL OF THE TAXPAYERS' GAIN ON THE TRANSACTIONS WITH RESPECT TO TRUSTS 473 AND 482 CONSTITUTED GAIN FROM THE SALE OR EXCHANGE OF CAPITAL ASSETS TAXABLE AS CAPITAL GAINS WAS CLEARLY WRONG AND SHOULD BE REVERSED ON APPEAL

A. Introductory

All the issues on appeal relate to the taxation of gains alized by the taxpayers from transactions involving Trusts 473 and 2.

On April 9, 1953, Kearney Park entered into a contract to pur- ase certain unimproved real property in San Diego, California. cover a portion of the purchase price it gave two notes secured trust deeds to the purchased property--the $80,000 note and 53,750 note. The property was located near the Miramar Naval Air ation. In August, 1955, newspapers publicized the fact that the vy was proposing to enlarge the air station and that additional nd, including the Kearney Park property, would have to be acquired r this purpose. (R. 94-96.)

In 1955, the notes were in default. Interest was delinquent. provement bonds and property taxes were also delinquent. The lder of the two notes was willing to dispose of the notes at a bstantial discount. B. B. Margolis learned of these facts and cured options for the purchase of the notes. (R. 96.)

In January, 1956, taxpayers Levikow and Howarth, together with argolis, purchased the $80,000 note for $30,000. In February, 1956, hese individuals created Trust 473 and transferred the note and rust deed to it. (R. 97.) In May, 1956, the taxpayers, Margolis d certain other individuals purchased the $553,750 note for 70,000. On June 4, 1956, these associates created Trust 482 and ansferred the note and trust deed to it. (R. 97-98.)

The declarations of trust provided that the trustee could, among her things, enter into agreements with the owner of the real estate curing the notes with reference to participation in any gain alized from the sale of the property. On June 15, 1956, the sociates, acting through the two trusts, entered into a new contract th Kearney Park superseding the original purchase contract of ril 9, 1953. By this new contract and its amendment of December 4, 57, the trustee agreed to postpone payment of the notes, waive all st defaults, and advance sums of money to Kearney Park to prevent eclosure of the improvement bonds and tax liens. In consideration refor, it was agreed that on the sale of the property, the proceeds ld be used to pay improvement bonds, taxes, principal of the notes h interest, and a sum of $150,000 to Kearney Park for its investment the land. The balance of the proceeds of the sale was then to be ided equally between Kearney Park and the trusts as was also any of land that remained unsold.

In February, 1958, an agreement to sell to the Navy was entered to by the trustee and Kearney Park. The sale was consummated in ril for a total consideration of $1,500,000 which was distributed in cordance with the agreement of June 15, 1956, as amended. Kearney rk at such time also conveyed to Trust 473, an undivided one-half erest in 114 acres of land not conveyed to the Navy. (R. 105.)

In March of 1958, Margolis sold to taxpayer Allen Sutherland his eficial interest in Trust 473 and 482 for $200,000.[3/] This took ce prior to the closing of the agreement with the Navy. (R. 105-.)

On distribution by the Trusts, the taxpayers, in effect, received categories of gain. The first included their pro rata share up to face value of the two notes and the second their pro rata share in proceeds from the sale of the real property to the Navy plus their rata share in the balance of the real property (approximately 114 es) not conveyed to the Navy.

In granting summary judgment, the District Court held (R. 121) all of the taxpayers' gain from transactions with respect to sts 473 and 482, with the exception of certain interest income on two notes accruing subsequent to their acquisition by taxpayers, tituted capital gains. The Court held that this interest income ordinary income. (R. 121.)

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argolis was allowed capital gains treatment with respect to the derived by him from this transaction (see the opinion of this t in Margolis v. Commissioner, 337 F. 2d 1001 (C.A. 9th, 1964)) his situation in this respect is clearly distinguishable from that he taxpayers here in that the latter retained their beneficial rest in the two promissory notes until they were paid off from the eeds of the Navy purchase.

The Government submits that the lower court's holding was clearly ong. It is our position that none of the gain qualifies for the vored capital gains treatment, under Section 1221(1) of the Internal venue Code of 1954, Appendix, infra, but that for the reasons stated low the entire amount thereof is properly taxable as ordinary income der Section 61(a) of the 1954 Code.

Income is taxed at capital gains rate if it consists of gains alized from the sale of capital assets as defined in Section 1221(1) the Internal Revenue Code of 1954. The capital gains provisions nstitute an exception to the normal tax requirements of the Code l are to be narrowly construed. Commissioner v. P. G. Lake, Inc., 5 U.S. 260; Los Angeles Extension Co. v. United States, 315 F. 2d 1 A. 9th). Thus, in construing the term "capital asset", the preme Court, in Commissioner v. Gillette Motor Co., 364 U.S. 130, instructed that (p. 134)--

> * * * not everything which can be called property in the ordinary sense and which is outside the statutory exclusion qualifies as a capital asset. This Court has long held that the term "capital asset" is to be construed narrowly in accordance with the purpose of Congress to afford capital-gains treatment only in situations typically involving the realization of appreciation in value accrued over a substantial period of time, and thus to ameliorate the hardship of taxation of the entire gain in one year.

with equal vigor, the Supreme Court has stated that the burden is the taxpayer to show by substantial evidence that the determination the Commissioner of Internal Revenue is erroneous. New Colonial Co. Helvering, 292 U.S. 435; Welch v. Helvering, 290 U.S. 111; Homann v. missioner, 230 F. 2d 671, 672 (C.A. 9th).

reover, on appeal in a case involving summary judgment such as this, e appellate court should view the case from a standpoint most vorable to the party against whom judgment is entered (Poller v. lumbia Broadcasting, 368 U.S. 464), and should liberally construe the idence in a light most favorable to the opposing party and resolve tual disputesin his favor (Cox v. American Fidelity & Casualty Co., F. 2d 616 (C.A. 9th); Pogue v. Great Atlantic and Pacific Tea Co., F. 2d 575 (C.A. 5th)).

B. The lower court was clearly in error in holding that the gain resulting from the payment to the taxpayers of the face value of the two promissory notes was taxable as capital gains rather than as ordinary income

A segment of the proceeds received by Trusts 473 and 482 resented payment of the face value of the two promissory notes d by those trusts. The Government submits that the proceeds which strictly attributable to payment of the notes represent the receipt ordinary income and are taxable as such.

Not every gain growing out of a transaction concerning alleged tal assets is allowed the benefits of the capital gains tax visions. Such gains are limited by definition to gains from "sale xchange" of capital assets. Section 1222(1) and (3), Internal nue Code of 1954, Appendix, infra. And generally, courts have sed to expand the meaning of the words "sale" and "exchange" and ruled that these words refer only to such transactions as would onsidered sales and exchanges in the business world. Fairbanks v. ed States, 306 U.S. 436; Bingham v. Commissioner, 105 F. 2d 971, (C.A. 2d); Wener v. Commissioner, 242 F. 2d 938, 942 (C.A. 9th).

Where an indebtedness is paid off and discharged, it was early
ld and has been well established that such a transaction does not
ount to a "sale" or "exchange" within the commonly accepted meaning
the words, and thus does not qualify for the favored capital gain
eatment. Fairbanks v. United States, supra; Miller v. United States,
2 F. 2d 584 (C.A. 6th); Wener v. Commissioner, supra; Graham v.
mmissioner, 304 F. 2d 707 (C.A. 2d). The Supreme Court in Fairbanks,
ra, p. 437, succinctly stated that--

> Payment and discharge * * * is neither sale nor exchange within the commonly accepted meaning of the words.

While the Supreme Court, in Fairbanks, used this language with
erence to the redemption of a bond, it is applicable to the payment
any debt as this Court has so firmly stated. Wener v. Commissioner,
ra, p. 942.

The rationale of this rule is that there is no acquisition of
perty by the debtor, no transfer of property to him. In point
law and in legal parlance, the property in the evidence of
ebtedness is extinguished, not sold. In business parlance, the
nsaction is a settlement and the evidence of indebtedness is turned
r to him, not sold to him. Wener v. Commissioner, supra, p. 943.

In the instant case, the proceeds which represented payment of
face value of the two notes represented the extinguishment of
debtors obligation, rather than sale or exchange of an asset.
king this essential element, the gain on the extinguishment of the
nissory notes was taxable to each taxpayer as ordinary income
ner than as capital gains. Fairbanks v. United States, supra.

Clearly, Section 1232 of the 1954 Code, Appendix, infra, does ot rescue the proceeds from payment of the notes from ordinary income reatment. That section provides, in relevant part, that amounts eceived by the holder on retirement of bonds or other evidences of ndebtedness, including promissory notes, which are capital assets in e hands of the taxpayer, shall be considered as amounts received in change therefor. However, that section excepts from its compass idences of indebtedness issued prior to January 1, 1955, which do t have interest coupons or are not in registered form. Because the o promissory notes were issued prior to January 1, 1955 (R. 94), and ither had interest coupons nor were in registered form, they are early outside the pale of Section 1232.

Additionally, it is the Government's position that the gain from e payment or retirement of the notes does not qualify for capital gains atment, since the gain represents discount income, the equivalent interest and is taxable as ordinary income. United States v. land-Ross Corp., 381 U.S. 54. In that case, the Court held that n on the sale of indebtedness attributable to original issue count was but interest in another form and taxable as ordinary in-e. The Court instructed that (381 U.S., p. 57)--

> Earned original issue discount serves the same function as stated interest, concededly ordinary income and not a capital asset; it is simply "compensation for the use or forbearance of money." Deputy v. du Pont, 308 U.S. 488, 498; * * *. Unlike the typical case of capital appreciation, the earning of discount to maturity is predictable and measurable, and is "essentially a substitute for * * * payments which §22(a) expressly characterizes as gross income [; thus] it must be regarded as ordinary income, and it is immaterial that for some purposes the contract creating the right to such payments may be treated as 'property' or 'capital.'

Here, the difference between the price taxpayers and their sociates paid for the notes and the face values of the indebtedness presents a discount in the value of the notes, payment for the use forbearance of the money, and the proceeds attributable to that scount represent an income item, taxable as ordinary income. See rn Products Co. v. Commissioner, 350 U.S. 46, 52; Commissioner v. G. Lake, Inc., supra.

C. The lower court was clearly in error in holding that the gain realized by the taxpayers on the sale of the Kearney Park land and the distribution of one-half of that portion of such land as was not sold, was taxable as capital gain rather than as ordinary income

In consideration for their advances to Kearney Park and their ebearance of the collection of the principal and interest on the two missory notes, the taxpayers, through Trusts 473 and 482, acquired right to share equally in the profits from the sale of the land and o equally in any land that remained unsold which right was secured by rust deed to the property. (R. 100-101.) Upon sale of the land to Navy, the taxpayers received not only a proportionate part of the ceeds in the taxable year here in issue but also acquired propor-nate interests in one-half of the Kearney Park realty that was not d to the Navy.[4/] The issue is whether the gain derived from the sale the land and the acquisition of the land which was not sold is taxable the taxpayers as ordinary income or capital gain.

Resolution of this issue depends upon whether the interests in the perty held by the taxpayers through the trusts was property

4/ It is obvious that the Navy intended to acquire the entire Kearney Park ct but was prevented from doing so by a cut-back in the funds made ilable to it. (R. 104.) Thus it is obvious that the remaining land tributed to taxpayers in kind represented a part of the gain or profit ived by them from the consummation of their joint venture.

eld by taxpayers primarily for sale to customers in the ordinary course f business, and therefore not a capital asset within the meaning of ection 1221(1) of the Internal Revenue Code of 1954. The position f the Government is that taxpayers' interests in the realty were held rimarily for sale to customers in the ordinary course of business id therefore were not capital assets, within the meaning of the Code, ntitled to capital gain treatment.

The question of whether the property involved was so held within e meaning of the exclusionary language of Section 1221(1) is essential- a question of fact to be determined from the circumstances of each se. Wineberg v. Commissioner, 326 F. 2d 157 (C.A. 9th); Los Angeles tension Co. v. United States, supra; Starke v. Commissioner, 312 2d 608 (C.A. 9th); Austin v. Commissioner, 263 F. 2d 460 (C.A. 9th). single factor is conclusive, but the determination must depend on l pertinent facts and their relative importance. Rossiter v. ited States, 282 F. 2d 892 (C.A. 7th).

The Government first submits that in the light of the present cord there is strong evidence to establish that the property erests held by the taxpayers were held primarily for sale to stomers in the ordinary course of business. Moreover, it is vious that the lower court's own findings on this issue do not pro- le a factual basis such as would permit a court to conclude by way summary judgment that the taxpayers qualify for favored capital ns treatment.[5/] Actually, the findings and conclusions of this Court

[5/] Of course, if it is considered that a dispute existed between the ties as to any material fact summary judgment should not have been nted in any event. Rule 56(c), Federal Rules of Civil Procedure; r v. Mac Dougall, 201 F. 2d 265 (C.A. 2d, 1952); Baron & Holtzoff, eral Practice and Procedure (1958 ed.), p. 130.

n Margolis v. Commissioner, 337 F. 2d 1001 (C.A. 9th), lend support
o the Government's position here. In that case, this Court had
efore it the precise problem here involved, the only factual difference
eing that Margolis disposed of his beneficial interest in the trusts
o taxpayer A. J. Sutherland prior to the completion of the sale of
ne Kearney Park land to the Navy whereas the instant taxpayers did
ot. In the Margolis case, supra, p. 1009, this Court stated:

> By the new agreement of June 15, 1956, the trusts acquired a new interest in the property--a right to share in any gain upon their sale. This right, secured by a trust deed to the property, constituted an interest in the equity of the property itself, which interest in property was held for sale by the trusts.
>
> For the reasons already discussed * * *, it was proper to disregard the existence of these trusts and to construe the holding for sale as if it were by the taxpayer himself and to construe his sale of his beneficial interest as a sale of property held for sale in the ordinary course of his business. (Emphasis added.)

Thus, the holding of this Court in the Margolis case that B. B.
rgolis held his interest in the Kearney Park land for sale to
stomers in the ordinary course of business supports the Government's
ntentions in the instant case, and accordingly we respectfully
mit that there is sufficient basis for the Court to conclude, as a
tter of law, that the property interests involved were not capital
ets.

Moreover, it is obvious under the circumstances involved herein
t the unimproved real estate in issue could have been held for no other
son, by both Margolis, taxpayers, and associates, than for sale.

rtainly, it was not held for the production of rental income since e property remained in an unimproved condition. Moreover, taxpayers d Margolis acquired their interests therein at a time when it was own that the land would be sold to the Navy. Given this, the maining issue is whether the taxpayers were in the real estate siness for the purpose of disposing of this property.

Where two or more individuals combine in a joint enterprise for eir mutual benefit, with an understanding that they are to share the profits or losses, each is to have a voice in the management, d the venture acquires property and holds it for sale to customers the ordinary course of the business of such venture, the profits e clearly taxable as ordinary income rather than as capital gains. key v. Commissioner, 334 F. 2d 719 (C.A. 9th); Brady v. Commissioner, T.C. 682, see also, Bauschard v. Commissioner, 279 F. 2d 115 (C.A. h).

In the Brady case, p. 688, the Tax Court pertinently espoused h principle as follows:

> It is generally recognized that a joint venture exists where two or more persons combine in a joint enterprise for their mutual benefit, with an express or implied understanding or agreement that they are to share in the profits or losses of the enterprise and each is to have a voice in the control or management. United States Fidelity & Guaranty Co. v. American Security Co., (M.D. Pa.) 25 F. Supp. 280. One of the characteristics of a joint venture is that usually it is formed to handle a single transaction, rather than to carry on a continuing business. West v. Peoples First National Bank & Trust Co., 378 Pa. 275. Where members of such a venture acquire property, improve its marketability when necessary, and then hold it for sale to customers in the ordinary course of the business of such venture, the profits are taxable as ordinary income rather than as capital gains. * * *

In the instant case, the taxpayers, along with Margolis, joined gether to acquire an interest in the Kearney Park realty after quisition of their respective interests in the two promissory notes. e taxpayers were originally invited by Margolis to participate in e acquisition of the notes because he was unable to handle the nancing of such acquisition by himself. The group acquired their terests at a time when it was common knowledge that the Navy was riously considering purchasing the entire piece of property. The xpayers advanced monies to enhance the eventual marketability of e realty. It is clear that profits, losses and expenses were to be ared equally and that all would have an equal voice in the management. . 96-105.)

Under these facts, we submit that the arrangement of taxpayers s a joint venture and that the sole purpose of the venture was to d the real estate for sale to customers in the ordinary course the venture's operations. Brady v. Commissioner, supra. It is aterial that taxpayers had other employment and business, for it well recognized that one may engage in two or more businesses. ldin v. Commissioner, 195 F. 2d 714 (C.A. 10th); Luckey v. missioner, supra.

The taxpayers pooled their capital for the purpose of uiring an interest in the land and thereafter selling it to lize a profit from their venture. The operation was a one-shot ration solely designed to dispose of the property at a profit

the course of the operations of the venture. For these reasons, e gain from these operations is clearly taxable as ordinary income.[5/]

CONCLUSION

For the foregoing reasons, the judgments of the lower court should reversed in total and remanded for entry of judgments for the Govern-nt.

Respectfully submitted,

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Attention should be called at this point to the fact that the erest in the venture acquired by taxpayer A. J. Sutherland from B. Margolis on March 14, 1958, was only held by the former from that e to April 11, 1958, when the proceeds from the venture were tributed to him, a period of less than one month. Accordingly, should s Court find that the gain derived by Mr. Sutherland from this erest is capital gain such gain would be a short term capital gain er the provisions of the Internal Revenue Code and should be so lected in the ultimate computation of his tax liability for the able year involved.

ternal Revenue Code of 1954:

SEC. 1221. CAPITAL ASSET DEFINED.

For purposes of this subtitle, the term "capital asset" means property held by the taxpayer (whether or not connected with his trade or business), but does not include--

(1) stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business;

* * *

(26 U.S.C. 1964 ed., Sec. 1221.)

SEC. 1222. OTHER TERMS RELATING TO CAPITAL GAINS AND LOSSES.

For purposes of this subtitle--

(1) Short-term capital gain.--The term "short-term capital gain" means gain from the sale or exchange of a capital asset held for not more than 6 months, if and to the extent such gain is taken into account in computing gross income.

* * *

(3) Long-term capital gain.--The term "long-term capital gain" means gain from the sale or exchange of a capital asset held for more than 6 months, if and to the extent such gain is taken into account in computing gross income.

* * *

(26 U.S.C. 1964 ed., Sec. 1222.)

SEC. 1232. BONDS AND OTHER EVIDENCES OF INDEBTEDNESS.

(a) General Rule.--For purposes of this subtitle, in the case of bonds, debentures, notes, or certificates or other evidences of indebtedness, which are capital assets in the hands of the taxpayer, and which are issued by any corporation, or government or political subdivision thereof--

(1) Retirement.-- Amounts received by the holder on retirement of such bonds or other evidences of indebtedness shall be considered as amounts received in exchange therefor (except that in the case of bonds or other evidences of indebtedness issued before January 1, 1955, this paragraph shall apply only to those issued with interest coupons or in registered form, or to those in such form on March 1, 1954).

* * *

(26 U.S.C. 1964 ed., Sec. 1232.)